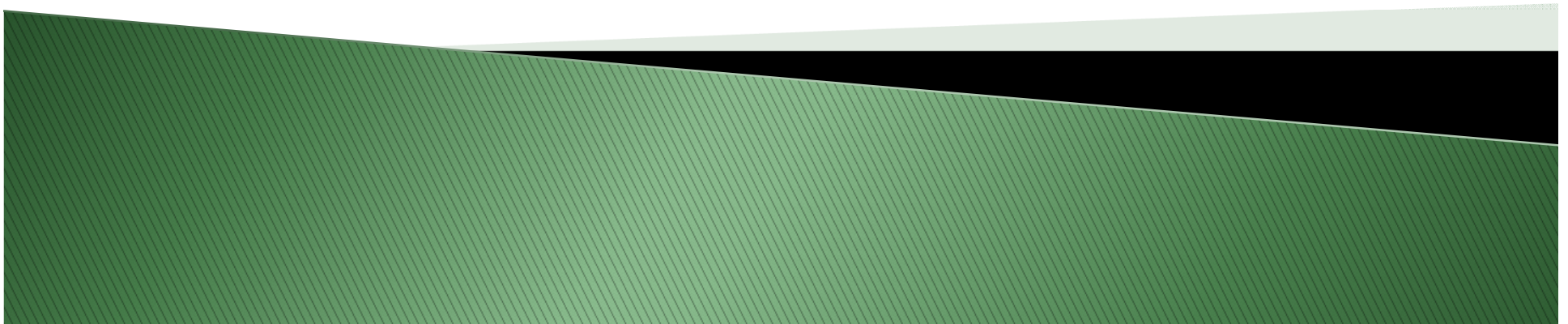


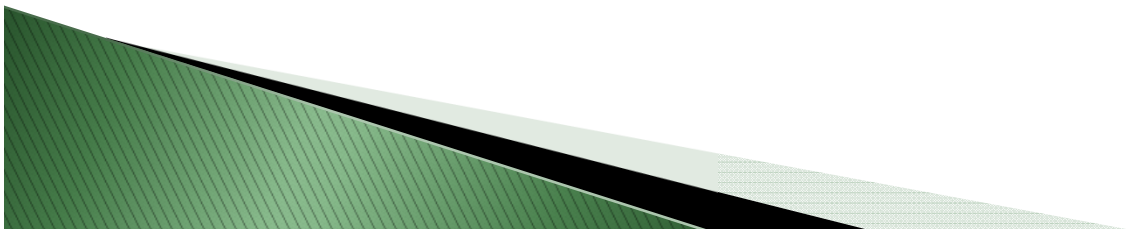
Unfunded Liabilities & Roadmap for Funding OPEB

March 4, 2014

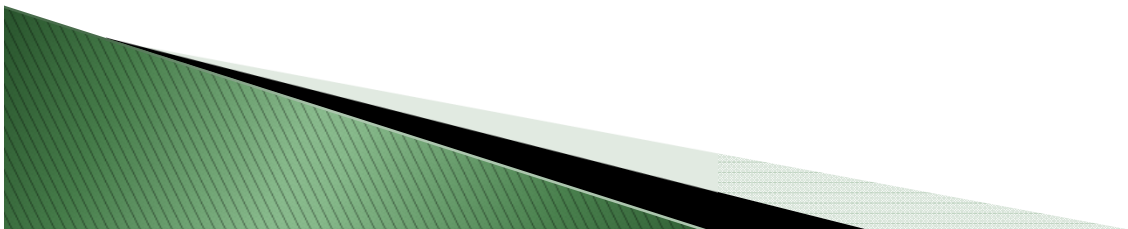


Agenda

- ▶ Background on Unfunded Liabilities
- ▶ MERSD's OPEB Challenge: size and underlying factors
- ▶ Roadmap to Full Funding and Timeline

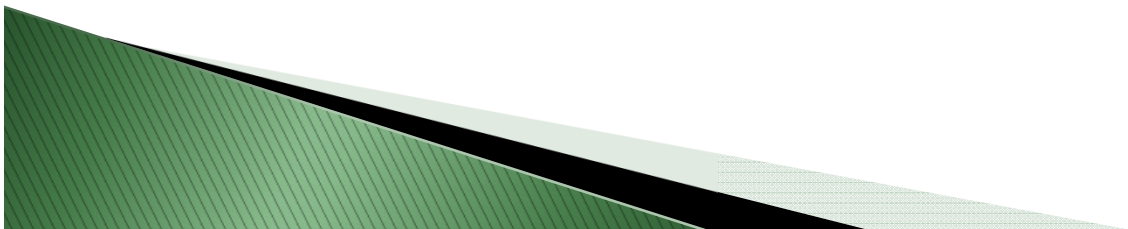


Unfunded Liabilities Background



What Are Unfunded Liabilities?

- ▶ Liabilities are future benefit payments for which obligation has already been incurred
 - ▶ MERSD's obligations are due per MA General Laws (MGL)
- ▶ A liability is fully funded if sufficient dollars are set aside *currently* to ensure obligations will be met in the *future*, factoring in opportunity to invest funds
 - ▶ Conversely, unfunded liabilities are amounts to be paid in the future, for which insufficient funding has been set aside today
- ▶ Governmental Accounting Standards Board (GASB) requires 3rd party actuarial valuation to size the liability and disclose assumptions



What Are MERSD's Unfunded Liabilities?

1. Pensions:

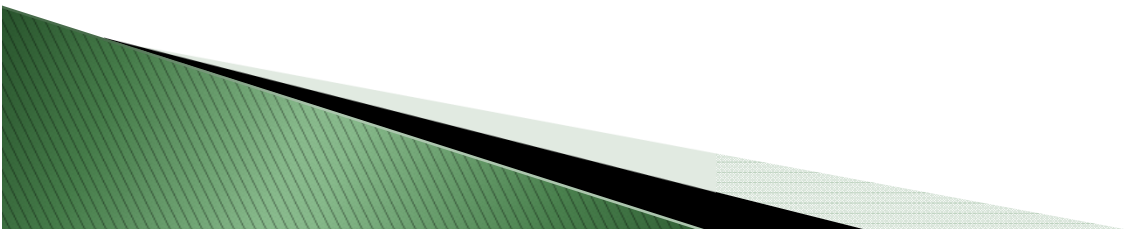
- ▶ Guaranteed by MGL for retirees w/20 years service or age 50 w/10 years
- ▶ MERSD has no pension liability for employees licensed by state
 - ▶ e.g., teachers, specialists, administrators
 - ▶ These employees contribute up to 11% of salary through payroll deductions
 - ▶ State (via MA Teachers Retirement System) pays 'employer match' not MERSD
- ▶ MERSD's has \$5.2 million unfunded pension liability for non-licensed staff
 - ▶ e.g., custodians, secretaries, teaching assistants, food service
 - ▶ This pension program is administered by Essex Regional Retirement System (ERRS)
 - ▶ Employees contribute + MERSD makes matching employer contribution (\$427K in FY-14 or \$6,276 per contributing active employee)
- ▶ Funding Status: MERSD on path to full funding, set by ERRS, requiring 7% annual increase in member contributions through 2019, 4% thereafter
 - ▶ MERSD has contributed 100% of its annual requirement each year

What Are MERSD's Unfunded Liabilities? (contd.)

2. Retiree Healthcare (aka Other Post Employment Benefits, or OPEB)

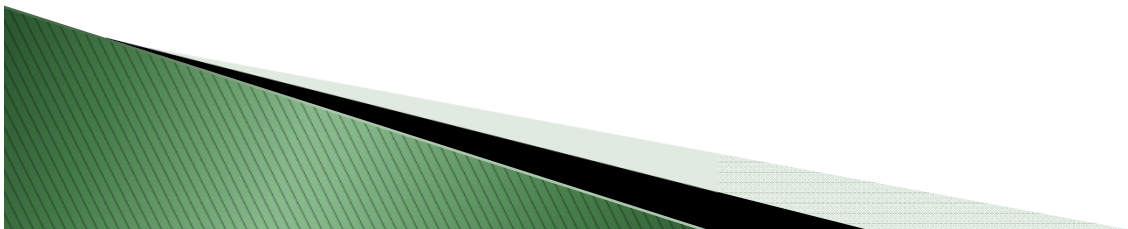
- ▶ Guaranteed by MGL with minimum 50% employer contribution rate for any employee retiring with pension eligibility
- ▶ MERSD retirees receive same contribution split as active employees per META contract and School Committee policies
 - ▶ 70% employer paid, 30% employee paid for hires after 7/1/13
 - ▶ 80% employer paid, 20% employee paid for all others
 - ▶ Average annual cost per retiree to MERSD: \$7,856, including payments for spouses (spouses covered until death of retiree)
- ▶ Size of OPEB liability = \$39 million present day value of MERSD's future benefit payments.
 - ▶ Only 26% of this amount relates to projected costs of current retirees; remaining 74% is projected benefit costs for active employees (i.e., once they retire)
 - ▶ Full actuarial report of MERSD's OPEB liability is available at www.mersd.org (quick link budget; choose unfunded liabilities)

MERSD's OPEB Challenge: Size and Underlying Factors



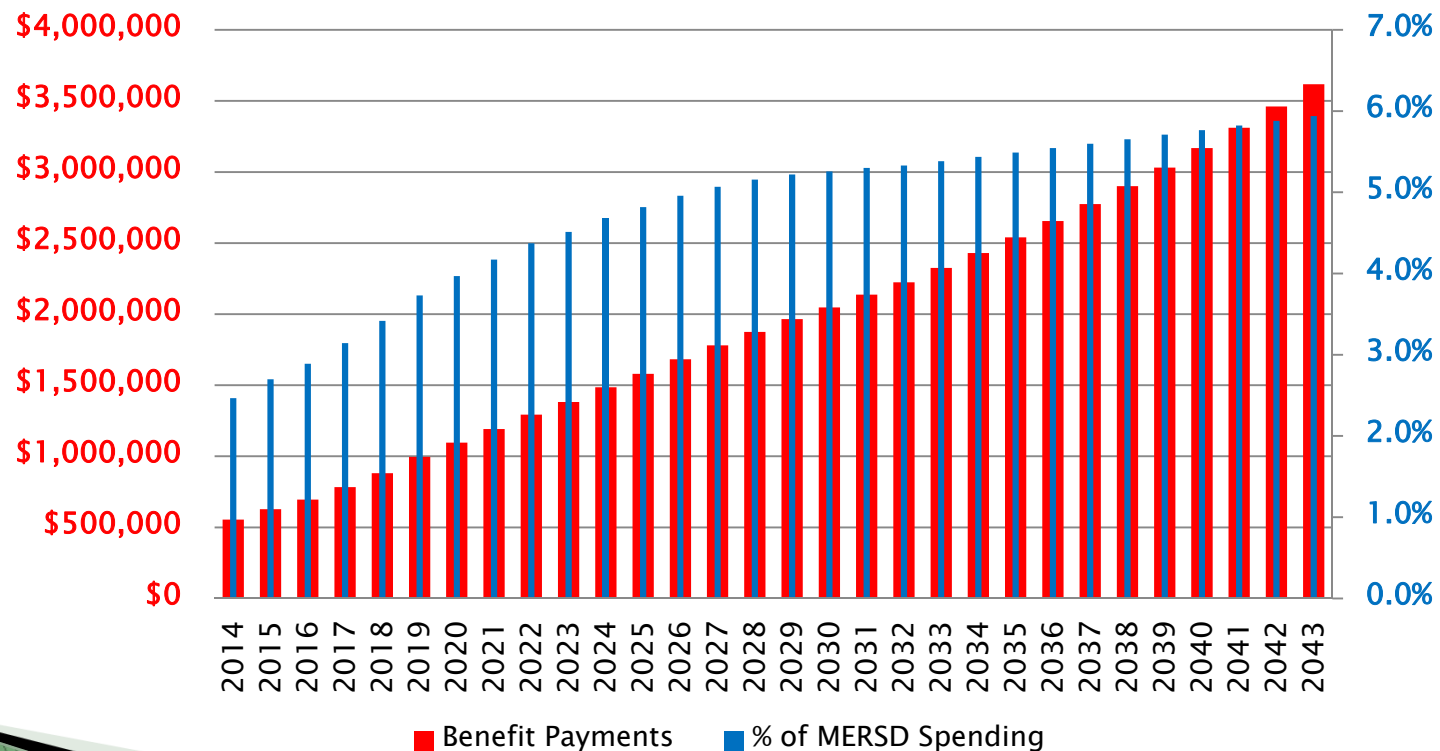
MERSD's OPEB Funding Status

- ▶ MERSD does not currently set aside any funds for future OPEB payments
 - \$560K annual budget for retiree health pays only for insurance premium due in current year for current retirees (i.e., MERSD's 80% contribution)
- ▶ Pre-funding not required by law, but lack of pre-funding creates future budgetary and default risk
 - MERSD's actuarial report projects 546% growth in annual premium payments over 30 years, far outpacing budget growth, due to:
 - Rapid increase in number of MERSD retirees
 - Increases in cost of insurance



With No Action, OPEB Will Outgrow Budget

- ▶ Annual premium payments (now at \$560K) forecast to hit \$1.1 million by 2020, \$2.0 million by 2030, and \$3.6 million by 2043
 - Retiree health would grow from 2.5% to 6% of annual spending (assuming 3.5% budget growth), and crowd out of educational program



How Big is the Current Funding Gap?

- ▶ MERSD has \$1.8 million annual OPEB shortfall
 - = \$2.3 million annual contribution needed to get on path to full funding, less \$560K actual MERSD budget for retiree healthcare
- ▶ Why is MERSD's funding shortfall so large?
 - Actual costs today are low, but projected costs are high, and full funding requires setting aside funds today to settle future costs
 - Retirees prior to regionalization remain obligation of member towns
 - Good news = fewer MERSD retirees and lower costs today
 - Bad news = rapid acceleration forecasted in number of retirees and costs, prior to reaching 'steady state'.
 - Large number of active and total participants relative to towns (eligibility determined by MGL)

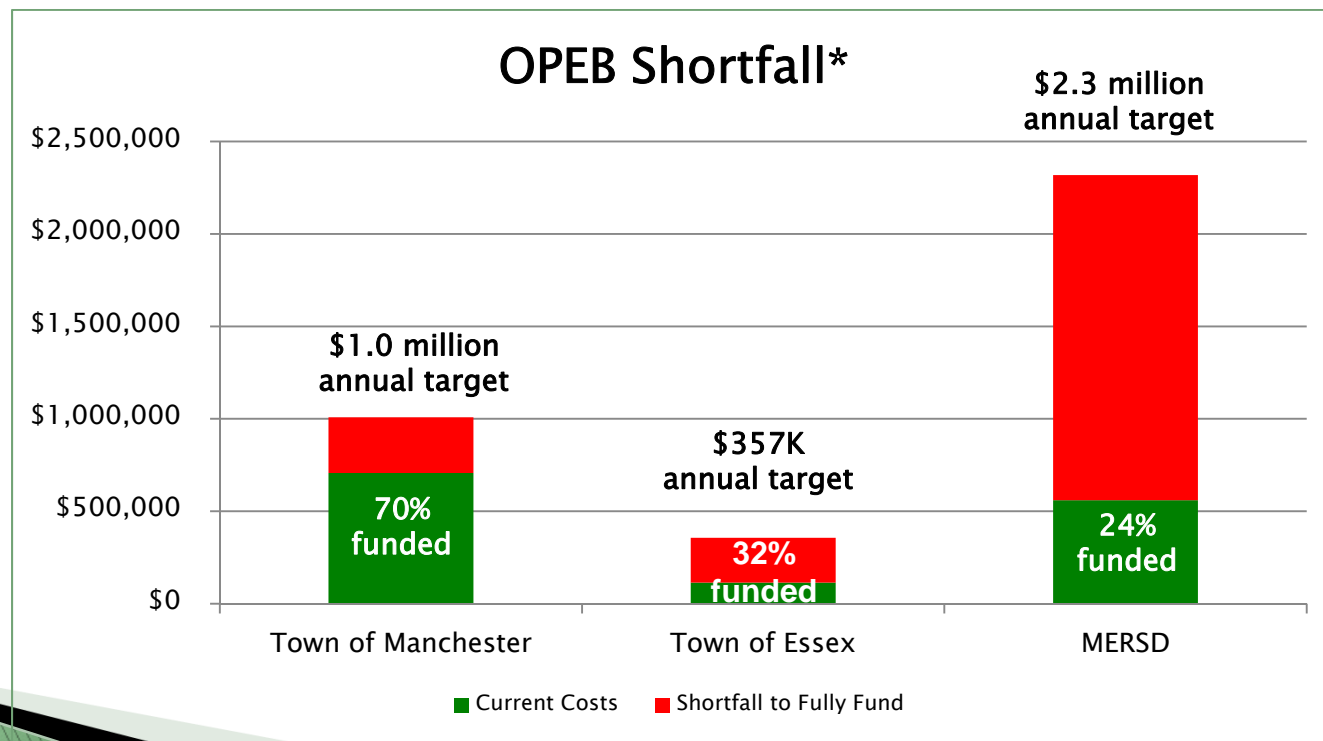
	Active Employees	Retirees*	Total OPEB Participants	Retirees, % of total Participants
Town of Manchester	61	179	240	75%
Town of Essex	32	22	54	41%
MERSD	227	113	340	33%

*includes covered spouses

This disparity explains forecasted spike in MERSD's OPEB costs

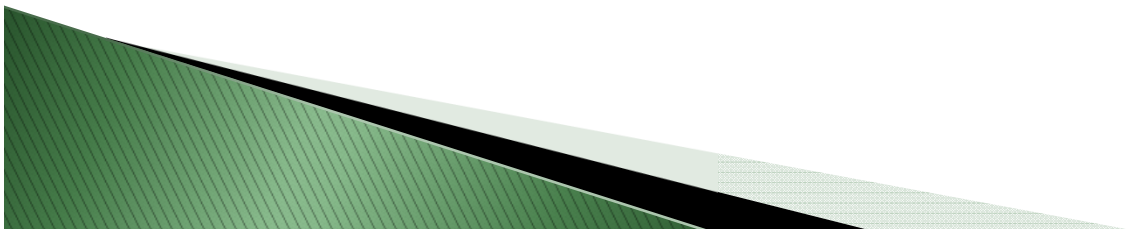
OPEB Shortfall: MERSD & Towns

- ▶ Current costs for towns are much closer to long-term trend rate:
 - So, a larger % of their annual OPEB target is currently “funded”
 - And MERSD’s annual shortfall to fully fund OPEB of \$1.8 million is much harder to close vs. \$200–300K for towns



**As of most recent actuarial report, prior to recent changes in pre-funding by Town of Manchester*

Roadmap to Full Funding Status



What Options Are Available?

- Broadly, MERSD's OPEB challenge requires changes on both sides of the equation: *costs and funding*
- Cost of benefits must be reduced to avoid crowding out of educational program
 - MERSD's current benefits program is generous compared to comparable districts
 - Restructuring options could shift portion of costs to future retirees
 - Some changes must be collectively bargained
- Increased, recurring funding must be set aside in the annual budget as well
 - Restructuring benefits cannot close the entire gap
 - Additional funding signals commitment to important employee benefit



Proposed Roadmap Components

1. Take steps within MERSD's control to reduce costs
 - Municipal Health Reform (MHR) law allows MERSD to change plan design outside of the negotiation process
 - Lowers long-term OPEB liability (and annual costs) by up to 10%
 - If budget held flat, savings could go into trust, closing gap further
 - Solves only 1 / 3 of OPEB gap; \$1.2 million annual gap would remain
2. Negotiate cost reductions that must be bargained by law
 - Contribution rate changes for retirees and/or spouses could lower gap by addition 50–60%
 - If possible, exempt current retirees and those near to retirement
 - Ideally, allow META choice between options of equal value as well
3. Increase budget funds over time to close remaining gap
 - Aim for 5–10 year time frame to gradually ramp up pre-funding investment, provided other budgetary priorities can be met as well



Closing the OPEB Gap

► Potential roadmap(s) towards full funding:

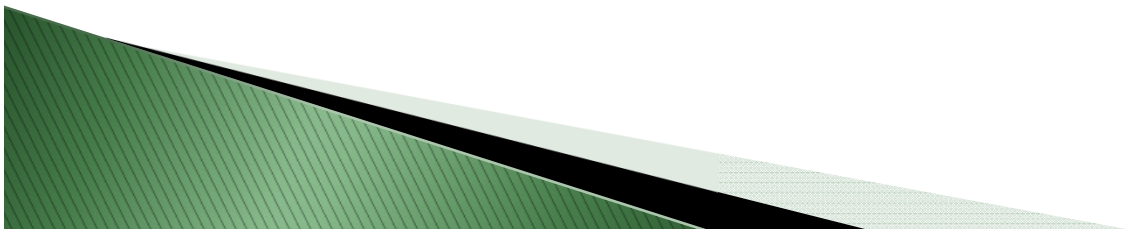
		Amount Needed to Fully Fund	\$2,318,685	
		Current Annual Budget, Retiree Health	\$560,000	
		Shortfall	\$1,758,685	
These changes can be made unilaterally	{	Migrate to Benchmark Plan	(\$231,869)	<i>Assumed 10% reduction in Amount to Fully Fund</i>
		Use savings to fund OPEB	(\$280,000)	<i>If benchmark plan adopted by active employees as well</i>
		Adjusted Shortfall	\$1,246,817	
			Shortfall	
		<u>Additional Options*:</u>	<u>Reduction</u>	
Collective bargaining required	{	Future retirees at 70/30	(\$829,584)	
		Future retirees at 60/40	(\$924,504)	<i>* Assumes contribution changes only for active employees <60 years old or <55 w/20+ years of service</i>
		Future retiree spouses at 50/50	(\$747,314)	
		Future retiree spouses pay 100%	(\$1,039,283)	

Remaining shortfall of \$200–300K could be addressed via gradual (i.e., multi-year) increase in budgeted funding

Estimated savings of “Additional Options” calculated by Sherman Actuarial Services

Next Steps & Timing

- ▶ School Committee decisions on:
 - Whether to use Municipal Health Reform (MHR) option to pursue plan design change for FY-15.
 - Priority of other OPEB cost reduction options within broader context of negotiation strategy/objectives
 - Investment strategy for MERSD's OPEB Trust Fund, if MHR option is pursued.



We Are Not Alone

- ▶ OPEB funding is a nationwide challenge
- ▶ An informal survey by our actuary showed:
 - 50% of governmental entities are doing nothing at all to address future OPEB liabilities
 - Just 1–2% are fully funding OPEB liabilities today
 - Remainder are either pre-funding an insignificant amount each year or on a multi-year plan to migrate towards full funding
- ▶ Community members and bond rating agencies are increasingly asking what Massachusetts' (and MERSD's) plan will be
 - As time passes, cost of closing gap increases